Who's afraid of internationalization?

Vale's offer to purchase Xstrata reawakened some old prejudices regarding Brazil's investments abroad. But the basic question remains: in a globalized economy, can you afford to stay out of the game?

BY ELIANA SIMONETTI, WITH COLLABORATORS

Vale in Carajás: expansion outside of Brazil is the mining giant's main path to growth

PAULO AMORIM/AE

Over the last few years, Brazilian companies – especially the larger ones – have become aware of a new imperative, something they had never even dreamed of for most of their existence. For many of them, expansion into the international market has become their only real chance to increase sales, dilute operational risks and protect their home markets against attack by heavyweight competitors from abroad. For companies such as Vale, Gerdau, Embraer, Odebrecht and dozens of others, the expansion into new markets has become not just an option, but the main option for growth.

"There's a feeling of urgency because, even if later rather than sooner, it's increasingly clear that those who don't get moving, who don't globalize, will get run over," says economist Luis Afonso Fernandes de Lima, president of the Brazilian Society for the Study of Multinational Companies and Economic Globalization (Sobeet). "Here we are, taking our first steps when we need to be running, because this movement is not confined to Brazil and it's not something we can control."

According to Lima, in 2006 there were 78,000 multinational companies in the world, with investments totaling almost one quarter of the global Gross Domestic Product (GDP) – numbers no less than five times greater than in 1980. Just by looking at Brazilian companies, it becomes clear that the number operating overseas has grown and will tend to rise further in the next few years. One recent study by Accenture, a consulting firm, indicated that 10% of the 500 biggest Brazilian companies plan to go shopping for foreign assets. What lies behind all this interest?

Looking at the question from the point of view of companies' needs, the internationalization movement is extremely positive. In an open market regime with companies controlled by private capital, there is nothing that can be done to keep an ever-expanding amount of Brazilian capital from being used to purchase firms, build factories and generate jobs abroad. And therein lies the problem. At the beginning of the year, Brazilian President Luiz Inácio Lula da Silva announced publicly that Vale, who had just announced its plans to acquire control of Anglo-Swiss mining company Xstrata, should invest more in Brazil instead of looking so keenly abroad.

Two comments on the critique by the Brazilian president. First, Lula was referring specifically to Vale, but what he said could apply equally well to a considerable number of organizations, and second, he was not the first or only Brazilian to express reservations regarding international expansion.

One of the most highly-regarded economists in the country, former finance minister Antonio Delfim Netto, for example, decides to express a similar opinion every now and again. Others go even further:

"Vale is a big company, with vast revenues, but it is digging up ore from our ground, ruining our country and carrying away our wealth," a source close to the president told PIB. "It generates few jobs and doesn't pay very much tax. So I ask: should this type of company get incentives? Should it receive special treatment?"

Perhaps the question should be: does international expansion of companies represent any risk of harm to the country as a whole? Could jobs that national companies create abroad be generated at home if the financial resources that fund globalization were invested inside Brazil? That, perhaps, is one of the main issues to be debated at this moment when an increasing number of companies have unfurled their sails in search of new ports in which to drop anchor.

For the Brazilian government, the internationalization of a company like Vale gives rise to two worrisome issues. The first is with regard to payment conditions and eventual changes in the company's shareholder profile. The second is the need for the company to increase its presence in Brazil by amplifying and diversifying its activities. "It has to add value, create income, create jobs," said one government minister (see box on page 31).

In the specific case of Vale – which in the last week of March announced its decision to temporarily withdraw from negotiations with Xstrata, while indicating it may resume talks through the next six months – the situation must be analyzed with care.

Much has been said about the role that Vale's US$17 billion purchase of Canadian mining company Inco had in making 2006 the first year ever in which Brazil's overseas investments exceeded inward FDI. In terms of acquisitions, Vale has been especially voracious. Between 2001 and 2007, the mining giant acquired no less that 18 foreign companies. It has not, however, neglected its operations in Brazil. In October 2007, the company announced its 2008 investment plans with a projected total value of US$11 billion, the greatest amount in Vale's history. Investments will be split 65% for over 30 projects in Brazil, and the remaining 35% for projects in eight other countries.

Two of the Brazilian projects are typical of the company's diversification of activities and sound like an answer to President Lula's concerns. The first, previously announced, is the construction of a US$3 billion steel mill at Marabá, southwest Pará, in the Eastern Amazon region. The second, also a steel mill but this time in the Northeast state of Maranhão, is being discussed with the Indian Tata group. This US$3.9 billion investment would also involve the Brazilian Development Bank (BNDES) and the Gerdau steel group.

This mountain of money will add up to many jobs. At the end of March, Vale announced that over the next five years it plans hiring 62,000 employees to work at its operations all around the world. Nearly 80% of these will be destined to boosting Vale's workforce in Brazil. "Besides hiring, we are also investing heavily in employee training," says Maria Gurgel, Vale's director of Human Resources planning. This year, roughly 3,500 people will undergo intensive internal training courses.

The possible acquisition of Xstrata over the next few months could tip the scales in the other direction. Xstrata mines copper, coal, nickel and zinc in coun-

Vale: key data in perspective

The Brazilian company has announced the largest 2008 investment plan of all mining and steel companies in the world

(INVESTMENTS IN US$ BILLIONS, EXCLUDING ACQUISITIONS)

Vale	**11.0**
BHP Billiton	5.7
ArcelorMittal	5.2
Votorantim	4.8
Rio Tinto	4.5
Anglo American	4.3
Xstrata	3.7
Alcoa	1.9
Freeport-McRan Copper & Gold	1.5
Gerdau	1.1
Norilsk Nickel	1.0

SOURCE: COMPANIES

...and is the champion in returns according to the Total Shareholder Return Ranking (TSR)

(TSR PER YEAR BETWEEN 2002 AND 2006)

1. Vale	**54.6%**
2. América Móvil	53.3%
3. Apple	50.6%
4. British American Tobacco	25.8%
5. Genentech	24.5%
6. Anglo American	23.2%
7. BHP Billiton	3.2%
8. Endesa	20.8%
9. Toyota	20.7%
10. Boeing	20.1%

SOURCE: THE BOSTON CONSULTING GROUP

FERNANDO MORAES/FOLHA IMAGEM

Votorantim Celulose: the group should double offshore revenues in 2008, following acquisition of various cement companies

tries such as Argentina, Canada, Chile, Colombia, the Philippines, South Africa and the United States. Even so, US$7.1 billion of Vale's cash is set aside for new projects at home.

"Apart from China, which has an astounding domestic market, national companies that are focused on their respective internal markets will tend to disappear," says Stephen Cooney, an industry specialist at the U.S. Congressional Research Service. "To compete in a global arena that is in a process of consolidation, Brazilian iron and steel companies must diversify and grow."

10% of major Brazilian companies plan foreign acquisitions

There is one last aspect to be analyzed.

Vale is currently the number two mining company in the world, and is the world's most profitable company for shareholders, among companies worth over US$50 billion. It placed first in the 2007 Value Creators Report, a global ranking list organized by the Boston Consulting Group. The survey analyzed the performance of 610 companies in 44 countries between 2002 and 2006. Vale was also (understandably) Wall Street's favorite foreign company last year, according to average daily trading of American Depositary Receipts, or ADRs. BHP Billiton, the world's largest mining company, ranked seventh.

Judging by the moves made recently by a number of Brazilian companies, their overseas investments are likely to continue expanding.

A study by Rio de Janeiro's Federal University showed that, throughout the 1990s, direct investments abroad by Brazilian companies did not exceed US$2.5 billion, and the bulk of that sum could be traced to Petrobras. Today, the country has at least 20 companies that are prominent globally, with over 50 industrial units operating abroad. The continued, and more widespread, trend of internationalization of the Brazilian economy has also been detected by the United Nations Conference on Trade and Development, or Unctad, which tracks international investment flows in annual studies. The phenomenon is especially clear in sectors that are natural resource-intensive, but it has also begun to appear among industrial companies. Two Brazilian firms made the list of the 25 largest transnational, non-financial companies in developing economies, classified by assets held abroad, published in Unctad's World Development Report 2007. They were Petrobras (13th place) and Vale (18th place).

The trend has been stimulated by the need to improve competition, of course, but also by recent favorable market conditions. Major infrastructure investments in China and soaring worldwide steel production have stimulated the formation of large groups in both mining and steel. Other segments are also benefited by Chinese advancement. Take, for example, the case of airplane manufacturer Embraer.

In 2002, the company began to manufacture aircraft in China. A joint venture with the Chinese communist government resulted in the creation of Harbin Embraer Aircraft Industry Company, located in the city of Harbin, 150 kilometers northwest of Peking, for the production of ERJ 145 jets. The company is working on an order of 50 jets to be assembled at the Chinese unit. China has also purchased another 50 Embraer 190s, built in Brazil. "I believe we would not have sold the nationally produced airplanes had we not been present in China," says Horacio Forjaz Aragones, vice-president of administration and communication at Embraer. "Results obtained with internationalization more than compensate for the energy and dedication required to overcome obstacles."

Offshore expansion will seem natural in the coming years

The most ingenious entrepreneurs have already discovered this. They have come to realize that exports from Brazil do not guarantee a global presence, something that becomes much easier when a foothold has been firmly achieved in production areas of other countries. The overseas presence helps companies increase their awareness regarding local needs and contributes to reducing the cost of accessing clients. "It is an absolutely natural trend that the leading companies in emerging countries become international," says Wieland Gurlit, a McKinsey consultant specialized in mining and steel.

The trend impacts both private companies like Vale and state-owned Petrobras. The oil giant's international investments, adjusted by the dollar-real exchange rate from 2004, leapt from a modest US$139.9 million in 1990 to US$3.3 billion in 2006. The rise in petroleum prices has given Petrobras increased liquidity, but this only partly explains the company's determination to become a worldwide oil player. "We will be one of the five largest integrated energy companies in the world," says Petrobras President Jose Sergio Gabrielli. To get there, the company has approved investments of US$112.4 billion between 2008 and 2012, of which 13% is destined to other countries and 87% to Brazil. The United States, Nigeria, Argentina, Angola, Venezuela, Colombia and Turkey are some of the destinations for the company's resources.

Movements such as this have the potential to be considered increasingly natural business decisions from here on. One of the trailblazers along this path, the Gerdau group, is now in its second year as top of the international company list in the Brazilian Transnational Ranking, produced by the Dom Cabral Foundation of Minas Gerais in conjunction with Columbia University of the United States. In 2007, Gerdau totaled 12 international acquisitions. Brazilian units accounted for 47% of the steelmaker's R$34.2 billion gross revenues that year. Industrial plants in the United States and Canada contributed 33.3%, Latin American units (excluding Brazil) accounted for 10.6% and Spain represented 9.1%. "The growth platform for the Gerdau group in the international steel scenario has been enlarged. We will follow our strategy of growth with profitability and maintain elevated standards of competi-

Embraer: factory in China guarantees orders for aircraft made in Brazil

(LEFT) HANDOUT/EMBRAER — (RIGHT) LALO DE ALMEIDA/FOLHA IMAGEM

tion," said the group's president, Andre Gerdau Johanpeter, when he announced the company's results.

The Dom Cabral study comes at a good time. "We evaluated how much representation each company has abroad, in terms of assets, sales and jobs," explained Luiz Carlos de Carvalho, the Dom Cabral Foundation's international business coordinator. The survey showed that the 20 Brazilian companies with greatest overseas assets have over US$65 billion invested outside of Brazil. It also showed that Brazil is Latin America's greatest investment exporter, and the second among all developing countries.

Be that as it may, what is certain is that despite passionate discussions sparked now and in the future by the question of internationalization, Brazilian companies will continue to tread the global path. Autoparts manufacturer Sabó already has factories in Germany, Austria, Hungary and the United States, it is building one in China and is reaching out to India (see story on page 42). Meatpacker JBS-Friboi is on a non-stop acquisition drive worldwide (see Antena section). And like Friboi, other sectors with little or no experience in international investment are seeking new spaces abroad. It is an exceptional moment for a number of reasons.

First of all, there are many businesses for sale, not just in developing countries but also in developed and industrialized countries. Second, there is presently a vast supply of credit available and Brazil is no longer seen as a high-risk country. Besides, with the strengthened real, external investments have become relatively cheap. Thus it is that Rio Grande do Sul custom-made furniture company Unica, which controls the Dell Anno brand, has been multiplying its stores in Latin America and is now also present in Europe, with extremely positive results: an increase in the number of employees, along with expansion of installations and revenue in Brazil. "We have a bold plan for growth and internationalization," says the company's export manager, Juliano Barreti.

Wherever you look, there are more examples of how this process is irreversible. The beginning of 2008 has been incredibly busy for Votorantim, for example. The group took over the Colombian steel mill Acerias Paz del Rio in which it already had minor participation. Votorantim Cimentos purchased U.S.-based Prairie, one of the largest concrete and aggregate companies in the U.S. Midwest. The new acquisition has been integrated into the company's subsidiary Votorantim Cement North America, which operates in conjunction with Canadian group St. Mary's Cement, purchased by Votorantim in

THE GOVERNMENT POSITION

PIB INTERVIEWED one of President Lula's closest ministers regarding Vale's possible purchase of Xstrata, now temporarily on ice. Below, the government's general position on the operation:

"The government is not for or against internationalization. It is an inevitable process, a fact of life. The consolidation of the Brazilian economy, with an ever-increasing presence in the international scenario over the last 10 years, has also resulted in increased activity by Brazilian companies overseas. Brazil's government has every interest in the continuing extension of Vale's presence all around the world. If it does end up buying Xstrata, it will have more clout in South America, which is very positive.

The problem is the following: what is good for a company is not necessarily the best for the country. Vale has to say how it will pay for Xstrata. If payment is carried out in voting shares (common shares), it may be a problem because, in theory, you may not be internationalizing as much as denationalizing. One argument could be that participation used as payment will be smaller than the sum total that all Brazilian shareholders possess. Maybe, but that doesn't prevent the creation of a situation of potential weakness, one that makes Vale vulnerable to a maneuver of share composition and consequently to undesirable offers. We cannot have another AmBev. It all looks very pretty, but in fact it (AmBev) ceased to be under Brazilian control.

At the same time, Vale, in becoming a large multinational, has to make sure it is careful to continue being fundamentally a Brazilian company. It needs to have a strong presence in Brazil, and not only in mining segment, but also in activities that add value to the product. Why don't they have a steel mill in Pará? Or Maranhão? They argue that they cannot compete with their clients. Well, they could join their clients and bring some stability into the whole thing. They have to add product value, generate income and create jobs.

The BNDES and investment funds have an enormous participation in Vale. The deal with Xstrata will go through only if the government approves it. But the idea is not to get in the way. The president has neither illusions nor prejudice regarding businessmen, with whom he has negotiated his whole life. He knows they are people, flesh and bones, wanting to take advantage of situations – which is part of the game – but what they say or sell is not always the truth." *(Nely Caixeta)*

Inco: purchase of the Canadian mining company by Vale in 2006 was a landmark for Brazilian investments abroad

2001. By 2008, Votorantim Cimentos plans to double overseas revenues to US$1.5 billion.

These are just a few examples of a phenomenon that can be seen in several segments of the Brazilian economy, in all regions throughout the country. There are many advantages to this movement, according to Welber Barral, foreign trade secretary at the Ministry of Development, Industry and Foreign Trade. "There are benefits for companies and for the country. Companies are able to work around trade barriers and gain more stability, access to raw materials, scale and productivity. Furthermore there are intangible gains with regard to brand publicity and reputation on the international market. For the country, the expansion of investments generates new export opportunities and makes the Brazil brand widespread – which effectively multiplies business."

At this point, an example of a company in the service segment would be quite appropriate. Construtora Norberto Odebrecht (CNO) has a high degree of internationalization in terms of geographic dispersion, overseas activities and international experience. It began its activities outside of Brazil in 1979. One notable characteristic is the domino effect it causes in the country (see box on page 54). Another is the incredible capacity Odebrecht has to adjust to markets where it has staked a presence. "Our experience is highly successful," says the director of institutional relations for Odebrecht's engineering and construction activities, Roberto Dias. "We know each country has its own reality, customs and laws; everything is very specific, and we prepare people to understand this and integrate themselves to the environments in which we function."

A more or less generalized standard procedure among companies that invest in international operations is to begin their international career as exporters – allowing them to gauge market receptivity to their products, evaluate the competitiveness of what they have to offer, and identify at which locations around the world it would be most advantageous to sink roots. Sadia is a case in point. The foodstuffs company has just built its first overseas meatpacker at Kaliningrad, in Russia. A similar, although much older, experience belongs to Weg, a Santa Catarina company which is one of the world's top three electric motor manufacturers. Since 1996 the company has used the strategy of acquiring small factories and then consolidating its operations. Weg has subsidiaries in 20 countries and industrial units in Argentina, Mexico, Portugal and China. From the very start of the company's operations outside of Brazil, direct exports have also grown very quickly. Today, about 70% of Weg's external sales are destined to the company's overseas units.

There are plenty of examples that globalization is irreversible

Internationalization also has a number of positive side effects. One of these